

**Aqua Illinois, Inc.**

**Vermilion Division**

**Testimony  
Exhibit 3.0**

**Harold Walker**



**Gannett Fleming**

**GANNETT FLEMING, INC.**  
P.O. 80794  
Valley Forge, PA 19484-0794

December 21, 2007

Location:  
Valley Forge Corporate Center  
1010 Adams Avenue  
Audubon, PA 19403-2402

Ms. Kimberly A. Joyce  
Manager of Regulatory Affairs  
Aqua America, Inc.  
762 West Lancaster Avenue  
Bryn Mawr, PA 19101

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Dear Ms. Joyce:

In response to your request, the Valuation and Rate Division of Gannett Fleming, Inc. is pleased to provide or recommend an appropriate overall rate of return that Aqua Illinois, Inc. ("Company") should be afforded an opportunity to earn on their Vermilion County Division's utility service rate base. Based upon a review of current information, an overall rate of return of 9.343% based upon the Company's future test period average 2009 capital structure, including an 11.75% cost of common equity, is recommended. However, it should be noted that a full-scale company specific cost of equity study has not been conducted at this time. In the event that this rate filing is fully litigated, it may be necessary for one to be performed.

The first step in developing an overall rate of return is the selection of capital structure ratios to be employed. Next, the cost rate for each capital component is determined. The overall rate of return is the product of weighting each capital component by its respective capital cost rate. This procedure results in the Company's overall rate of return being weighted proportionately to the amount of capital and cost of capital employed by each class of investor.

Based on a review of the Company's current capital structure ratios, I believe it is appropriate to evaluate the current cost of capital based upon the Company's future test period average 2009 capital structure, that include 47.62% debt, 0.24% preferred stock and 52.14% common equity which are shown on the Company's filing in Schedule D-1. The Company's future test period average 2009 common equity ratio of 52.14% is similar to but higher than ratios employed by other larger investor-owned water companies. The Company's small size justifies the use of more equity capital than other larger investor-owned water companies in order to counterbalance some of the risk associated with its size.

Based on a review of the Company's embedded cost rates, I believe it is appropriate to use the Company's future test period average 2009 embedded debt cost rate and embedded preferred stock cost rate, of 6.73% and 5.47%, respectively, that are developed from the Company's filing in Schedule D-1.

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Based upon the recommended capitalization ratios, estimated embedded cost rates, and 11.75% return on common equity, a reasonable overall rate of return of 9.343% is indicated at this time, as calculated below:

<u>Type of Capital</u>	<u>Ratios*</u>	<u>Cost Rate*</u> (%)	<u>Weighted Cost Rate</u> (%)
Debt	47.62 %	6.73	3.204
Preferred Stock	0.24	5.47	0.013
Common Equity	<u>52.14</u>	11.75	<u>6.126</u>
Overall Cost of Capital	<u>100.00</u> %		<u>9.343</u>
* - Ratios and embedded cost rates are from Schedule D-1.			

We appreciate the opportunity to provide you with our recommendation. If you have any questions, please let me know.

Respectfully Submitted,  
GANNETT FLEMING, INC.



HAROLD WALKER, III  
Manager, Financial Studies  
Valuation and Rate Division

CC: Mr. Paul Hanley

HW:amp